

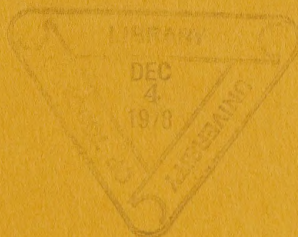
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# ***the refundable child tax credit what it is...how it works***

a background paper  
prepared by  
the office of the  
national council of welfare

august 1978







THE REFUNDABLE CHILD TAX CREDIT  
WHAT IT IS ... HOW IT WORKS

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A Background Paper

Prepared by the Office of the  
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## INTRODUCTION

On August 24 the federal government announced what may well be the most far-reaching restructuring of its programs of financial support for families with children since the introduction of family allowances. For the first time the federal income tax system will be used to deliver benefits to low and middle-income families, including all of those with incomes below the poverty line. Unlike the usual tax cuts of the past which automatically excluded those so poor that they already paid no income tax, a new mechanism - a \$200 refundable Child Tax Credit - has been designed that will provide full benefits to these poorest of families who are most in need. The same benefits will be provided as well to virtually all other families with incomes below the national average. As incomes rise above the average and the need for financial support diminishes, the benefits will be gradually reduced and finally phased out.

First benefits under this new Child Tax Credit program will be paid during the early months of 1979. They may be claimed by any parent in receipt of a family allowance (which in virtually all two-parent families means the mother).

To finance the refundable Child Tax Credit, the government has proposed three changes to existing programs. Starting in early 1979 family allowances will be reduced to \$20 a month from the current level of \$25.68. The higher exemption in the personal income tax for dependent children aged 16 and 17 will be reduced to the same level as the exemption for children aged under 16. And the existing tax reduction of \$50 per child will be eliminated.

The combined effect of these three changes along with the refundable Child Tax Credit will be an increase in the benefits received by 1.9 million families with the greatest need and small decreases for 1.7 million families with incomes above the national average. In place of the schedule of benefits created by the present family allowance, tax exemption and tax reduction - a schedule which, for a family with two children, goes from \$616 at the bottom of the income scale to almost \$1,000 at the top - the situation will be reversed. Greatest benefits will go to those at the bottom and middle of the income range, and smaller benefits will go to those at the top. A poor family with two children, headed by a worker earning the minimum wage, will receive \$264 more next year than at the present; a \$30,000-a-year family will give up \$52.

The changes which the federal government has proposed are very similar to the recommendations made by the National Council of Welfare in its March 1978 report Bearing the Burden/ Sharing the Benefits. These changes bring both greater equity to the tax system and greater efficiency to the income security system. While they admittedly will not eliminate poverty - their benefits are far too modest to do that - they will increase the incomes of the poor. And, perhaps most significantly, they provide a base on which governments can build in the future.

The Council believes it is essential that Canadians understand what is being proposed and how it will affect each of us, especially how it will benefit low and moderate-income families. Only six years ago an earlier attempt at restructuring income programs, the Family Income Security Plan, failed to be implemented because many of its intended beneficiaries did not realize what they would gain from it, while many of the organizations concerned about the poor condemned the scheme because it did not solve all problems overnight.



The purpose of this background paper is to summarize the essential features of the restructured programs. It consists of two parts. The first discusses the general concept of a refundable tax credit and examines specifically the new Child Tax Credit. The second part looks at the combined effect of the Child Tax Credit and the other changes for families at various income levels.

THE REFUNDABLE  
CHILD TAX CREDIT

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Most people think of taxation only in terms of taking money from individuals and paying it to government. Undeniably this is the primary result of taxes, but it is not the only one. The tax system can also be used to provide benefits to families and individuals. In fact, it can even be made to provide money to persons with incomes so low that they are below the tax-paying threshold. The mechanism for accomplishing this is a refundable tax credit.

For persons with incomes in the tax-paying range, a refundable credit simply means a reduction in the amount of tax which need be paid. With a \$200 tax credit, for instance, a taxpayer would calculate his or her income tax in the usual manner but then would deduct the amount of \$200 from what he owes. For those low-income persons whose tax is less than the amount of the credit, or who owe no tax at all, the refundability of the credit ensures that they also receive a full \$200 in benefits because the difference is paid by the government to the individual.

Refundable tax credits need not, however, provide the same size benefits to all. If the intention is to provide greater benefits to those with low and moderate income, this can be done through a diminishing refundable tax credit - a credit whose value is reduced by some percentage of income beyond a certain level.

This is precisely how the proposed refundable Child Tax Credit would operate. A family will be eligible for a basic \$200 tax credit for each dependent child aged under 18 (that is, each child for whom a family allowance is paid). If the combined



income of the parents exceeds \$18,000, the basic credit will be reduced by 5¢ for each dollar of family income over \$18,000. For a family with two children, this means a full \$400 in benefits if income is below \$18,000, a diminishing credit if income is in the range between \$18,000 and \$26,000, and no credit at all when income is over \$26,000. Since the 1978 median income of families with children is around \$19,500, a substantial majority of Canadian families will receive some child credit, and a large proportion of families will, in fact, receive the full credit. The following table shows the benefits to which families of different size and income will be entitled.

Family Income	Number of children in the family			
	1	2	3	4
\$18,000 or less	\$200	\$400	\$600	\$800
20,000	100	300	500	700
22,000	0	200	400	600
25,000	0	50	250	450
28,000	0	0	100	300
30,000	0	0	0	200

To help families calculate their credit entitlement, a one-page claim form will be included with each January's family allowance cheque. The completed form will be submitted by whichever parent receives the family allowance. Except for father-led single-parent families, this is virtually always the mother.

If the mother works outside the home and earns sufficient income that her federal tax (before applying the credit) exceeds the value of the credit to which she is entitled, then her tax will be reduced by the amount of the credit. If, on the other hand, she earns only a small amount of outside income so that her federal tax is less than the credit, the difference will be refunded to her by the government. And if she owes no federal tax at all - either because she has no taxable income or because she has already paid all the tax she owes through tax-withholding by her employer - she will be refunded the full amount of her credit entitlement.

The refundable Child Tax Credit is slated to take effect for the 1978 taxation year. Thus low-income families eligible for refunds under the plan will be able to claim their first benefits by or before April 1979.

### THE RESTRUCTURED SYSTEM

At the present time there are three income support programs for families with children. The family allowance provides a taxable benefit of \$25.68 a month (\$308.16 a year) for each child aged under 18. The dependents' exemption excludes from income tax \$460 for each dependent child aged under 16, and \$840 for dependents 16 or over. An additional measure in the personal income tax allows a reduction in federal tax of up to \$50 for each child. Both the family allowance and the dependents' exemption are indexed to the cost of living.

Under the restructured system the \$50 reduction will be eliminated but the diminishing refundable Child Tax Credit of \$200 described in the previous section will be added. The family allowance will be reduced to \$20 starting in early 1979; it will continue to be taxable. (In Alberta family allowances will still vary according to children's ages, while in Quebec they will vary according to age and the number of children in the family; for these provinces the \$20 payment is only the average benefit for all children taken together.) The dependents' exemption will be retained, but at a uniform rate of \$460 for all children under the age of 18. All the parts of the restructured system will be indexed to the cost of living.

The table on the following page compares the benefits which a two-parent family with two children aged under 16 living in Ontario now receives under the existing programs and the benefits which this same family will receive in 1979 under the restructured system.



<u>Income</u>	<u>1978 benefits under existing programs</u>	<u>1978 benefits under restructured programs</u>	<u>Change</u>
\$ 7,000 or less	\$616.32	\$ 880.00	+\$263.68
10,000	798.15	1,014.78	+ 216.63
15,000	808.03	1,037.25	+ 229.21
20,000	825.72	973.84	+ 148.12
25,000	831.05	758.94	- 72.12
30,000	756.25	704.64	- 51.61

As the table shows, poor families will be \$264 better off in 1979 under the new system than they were this year under the existing programs. Very substantial gains will also be realized by families with incomes above the poverty line but below \$20,000. In fact, 1979 benefits will not fall below the level of 1978 benefits until family income exceeds \$23,000, well above the national average income. It is important to stress again that families eligible for increased benefits will be able to claim them during the first months of 1979, ensuring they will suffer no loss because of the decrease in family allowances.


AN APPENDIX  
FOR QUEBEC FAMILIES

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For Quebec families benefits are different from those shown in the table on the previous page. In part this is because the provincial government has taken advantage of provisions of the federal family allowances legislation which permits a province to vary allowances by the number of children in a family and by their ages, as long as the average payment for all children in the province taken together remains the same as the national average. As well, they are different because Quebec has its own supplementary family allowances program, and because there are no exemptions for children in the provincial income tax.

In 1978 federal family allowances to Quebec families are \$15.42 a month for the first child in a family, \$23.11 for the second, \$47.45 for the third, and \$59.13 for each child after the third; there is an additional \$6.42 a month for each child aged 12 years or over. The Quebec government has not yet announced how it will vary allowances in 1979 for different sized families and ages of children, so we don't yet know what the 1979 allowances in Quebec will be. However, if the variations are done as a straight proportional change from the present levels, payments next year would be \$12.01 for the first child in a family, \$18.00 for the second, \$36.95 for the third, and \$46.05 for each child after the third - with an additional \$5 for each child aged 12 or over. It should be stressed that these are only our estimates; the Quebec government could choose to vary the levels in some other way.

Needless to say, none of the changes affect the provincial family allowance program. Under this plan, families now receive from \$5.43 each month for the first child to \$10.87 for



the fourth and subsequent child. These payments are not subject to tax (except for children aged 16 and 17) and they are indexed to the cost of living.

Families in Quebec, of course, will be entitled to the same \$200 refundable Child Tax Credit as all other Canadians.

The table below compares the benefits which a two-parent family in Quebec with one child aged 10 and another aged 12 now receives under the existing programs (both federal and provincial) and the benefits which this same family will receive in 1979 under the restructured system.

<u>Income</u>	<u>1978 benefits in Quebec under existing programs</u>	<u>1979 benefits in Quebec under restructured programs</u>	<u>Change</u>
\$ 7,000 or less	\$691.80	\$ 986.24	+\$294.44
10,000	850.82	1,073.40	+ 222.58
15,000	858.45	1,087.92	+ 229.47
20,000	871.30	1,017.98	+ 146.68
25,000	871.15	789.58	- 81.57
30,000	793.49	724.48	- 69.01



## NATIONAL COUNCIL OF WELFARE

The National Council of Welfare was established by the Government Organization Act, 1969 as a citizens' advisory body to the Minister of National Health and Welfare. Its mandate is to advise the Minister on matters pertaining to welfare.

The Council consists of 21 members, drawn from across Canada and appointed by the Governor-in-Council. All are private citizens and serve in their personal capacities rather than as representatives of organizations or agencies. The membership of the Council includes past and present welfare recipients, public housing tenants and other low-income citizens, as well as lawyers, professors, social workers and others involved in voluntary service associations, private welfare agencies, and social work education.

Reports by the National Council of Welfare have dealt with income security, taxation, the working poor, children in poverty, single-parent families, social employment, social services, community organization, nutrition, legal aid/legal services, low-income consumers, poor people's groups and poverty coverage in the press.

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